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Item F describes the sequence to be used in determining which capital debt shall be reduced first. This is necessary because facilities often have more than one capital debt.

Item G is necessary to insure that the allowable interest expense on capital debt shall be computed assuming that the debt has been reduced by the required amounts.

Reasonableness:

Item A determines the amount of the capital debt reduction allowance. One of the concerns raised in the LAC Report, (p. xvi), is the excessive amount of debt financing in the ICF/MR industry and the instability which that creates. (LAC Report, 1983: p. xvi.) This item will result in increased stability to the industry through the prepayment of capital debt. In addition, the result will be less interest expense on capital debt which addresses the cost containment measures of Minnesota Statutes, section 256B.501, subdivision 3. Additionally, this subpart also rewards the accumulation of equity by increasing both the amount of the capital debt reduction allowance as the percent of defined equity is increased and also the portion of the amount which can be used at the discretion of the provider. The LAC Report also recommended that an allowance be based on the actual capital investment of the provider, and that a reward to encourage capital investment be provided. Both of those recommendations are accomplished by this item. This allowance is not related to a cost incurred by the provider. Additionally, interest income, for the most part, is not required to be offset against capital debt interest expense. Therefore, the combination of these two factors, both of which increase as the percentage of equity increases, results in a reasonable incentive for providers to accumulate equity. (See Exhibit G.) Furthermore, the provider, upon payment of the capital debt through amounts reimbursed by the Medical Assistance Program receives the unencumbered ownership of the capital assets.

Item B is a reasonable method to determine the percentage of equity since it divides the facility's allowable historical capital cost of capital assets as determined according to these proposed rule parts by the amount of defined equity.

Item C is reasonable because it does not require the reduction of capital debt when the provider is prohibited from prepaying the debt.

Item D is a reasonable method for determining the annual amount to be applied to each reporting year since it takes the per diem amount paid during the reporting year times the appropriate resident days of that reporting year. This results in the amount actually paid to the provider during the reporting year for the purpose of capital debt reduction.

Item E is reasonable since the amount included in the capital debt reduction allowance is paid solely for the purpose of accelerating principal payments on capital debt beyond the amounts included currently in the payment rates for that purpose. To permit these payments to be used contrary to this item would circumvent the intent which is to reduce capital debt and the related interest expense.

Item F is reasonable because it establishes as a first priority the reduction of a capital debt which is not currently being reduced by required principal payments. Those debts would never be paid off through other reim-

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bursement amounts. Since one of the objectives of including this payment in the rate is to reduce interest expense, it is reasonable that the amount be applied secondarily to the capital debt with the highest annual interest expense.

Since this subpart's purpose is to reduce capital debt, it is reasonable that item G state that the interest expense related to the portion of capital debt reduced be a nonallowable cost.

Statement of Need:

Subpart 6 establishes an energy conservation incentive. The rising costs of utilities and the periodic fuel shortages of the past few years have prompted prudent managers to take a harder look at ways of controlling energy costs. It is necessary to encourage conservation of energy. Therefore, some incentive to invest in energy conservation measures is appropriate.

Reasonableness:

An investment which results in a long-term reduction in utility and fuel costs qualifies as a cost containment measure for an efficiently and economically operated facility. The incentive provided is to allow interest expense on debt incurred for energy conservation measures, even though the resulting capital debt exceeds the 80 percent of historical cost limit imposed in subpart 3, item F. Also, for smaller investments which do not exceed \$1 per resident day, the provisions in part 9553.0035, subpart 8, which may have required the expenditure to be capitalized are waived.

It is also reasonable to require that these requests for exemptions be accompanied by an energy audit by a certified professional.

Statement of Need:

Subpart 7 determines reimbursement of lease and rental expense. The LAC Report discusses several problems regarding the reimbursement of lease or rental cost such as noncompliance with generally accepted accounting principles, diminished control of the state over investments, and increased costs when leased facilities are later purchased (LAC Report, 1983: p. 69.) Additionally, some leases between related organizations are not disclosed to the Department resulting in inappropriate payments. Other leases have escalator clauses which increase the cost of the lease automatically while the actual historical cost would decrease. In general, the cost of leasing a physical plant is more expensive than ownership. Since the Medical Assistance Program pays these costs, it is in the economic interest of the state to disallow lease and rental costs when ownership is less costly. This position is supported by Minnesota Statutes, section 256B.501, subdivision 3 which requires "cost containment measures that assure efficient and prudent management of capital costs" and limitations on the amounts of reimbursement for property.

Reasonableness:

Item A is reasonable in order to allow the lease or rental of depreciable equipment in cases where it is cost effective. Prudent management practices should allow for lease or rental costs when they are equal to or less than the cost of purchasing the same equipment. It is also reasonable

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to allow costs for the lease or rental of depreciable assets for a period of less than 60 days since it may not be cost effective to purchase assets which are used infrequently and for short periods of time.

Item B is reasonable because it is essential to establish the criteria by which providers and the department determine whether or not a lease is an arms-length transaction. Leases that result from sale and lease back arrangements are not considered arms-length in that they may allow providers to escape from limitations on depreciation and interest expense and gain additional reimbursement through rental agreements.

Leases that include options to buy at less than anticipated value presume that the difference will usually be covered by higher lease payments prior to purchase of the asset. It is reasonable not to reimburse these higher costs and the state will not consider these lease or rental agreements arms-length transactions.

Leases or rental agreements between related organizations are not arms-length transactions and must be reimbursed at cost.

Subitem 4 establishes that leases which are required to be capitalized in accordance with generally accepted accounting principles are not considered arms-length. Miller's Comprehensive GAAP Guide, 1984, (p. 26.09), lists four criteria to determine whether or not a lease should be capitalized:

- 1. "Ownership of the property is transferred to the lessee by the end of the lease term.
- 2. The lease contains a bargain purchase option.
- 3. The lease term, at inception, is substantially (75 percent or more) equal to the estimated economic life of the leased property including earlier years of use. (Exception: This particular criterion cannot be used for a lease that begins within the last 25 percent of the original estimated economic life of the leased property.)
- 4. The present value of the minimum lease payments at the beginning of the lease term, excluding executory costs and profits thereon to be paid by the lessor, is 90 percent or more of the fair value of the property at the inception of the lease, less any investment tax credit retained by the lessor and expected to be realized by them. (Exception: This particular criterion cannot be used for a lease that begins within the last 25 percent of the original estimated economic life of the leased property.)" (GAAP Guide, 1984: p. 26.09.)

Item C establishes which physical plant leases are allowable. This provision is a reasonable cost containment method which assures efficient and prudent management of capital assets (Minnesota Statutes, section 256B.501, subdivision 3.). Over the life of the physical plant, leasing is far more expensive than ownership. Therefore, it is reasonable for the state to disallow lease cost whether or not the lease is arms-length and to pay instead property related costs as if the lease did not exist. Additionally, were the state to allow the lease cost of physical plant, the intent of the Deficit Reduction Act, 1984, would be circumvented since sales of leased facilities by the lessor may increase the property costs of the facility. However, it is necessary and reasonable to allow the cost of arms-length leases that were entered into prior to January 1, 1984 since the

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temporary rule which introduced this provision became effective on that date. Likewise, it is reasonable to allow the cost of renewals or renegotiations of these leases provided that the cost does not increase.

Item D establishes what the state will pay in lieu of disallowed leases. It is reasonable to allow the provider to receive depreciation, interest, and other reasonable costs of the lessor such as real estate taxes because the costs of these assets are necessarily incurred for the quality care of residents in ICFs/MR. The lessor's historical capital cost of capital assets and historical capital debt will be used in determining allowable depreciation and interest expense on the capital asset. This provision assures that the costs that must be incurred by economically and efficiently operated facilities are reimbursed.

Item E is reasonable just to insure that lease costs which are allowed together with other property related costs of the facility do not exceed the investment per bed limit which applies to all providers.

Item F describes the conditions under which the capital debt reduction allowance will be paid to a provider with a capital lease. For those providers who lease from a related organization, it is reasonable to reimburse the capital debt reduction allowance based upon the combined equity of the lessor and the lessee. This recognizes the fact that the lessor and lessee are actually the same entity.

Item G states that depreciation on leased capital assets between related organizations is subject to the funded depreciation requirements in these proposed rule parts. This provision is reasonable because the lessor and the lessee are the same entity with the same benefits and obligations of ownership.

Item H describes how transactions involving the purchase of leased capital assets will be handled. It is reasonable to treat the purchase of a previously leased capital asset in a manner consistent with the acquisition of a used capital asset. It is then logical to apply the rules applicable to used capital assets as outlined in parts 9553.0010 to 9553.0080 to the previously leased capital asset. In order to limit an upgrading of the historical cost of the capital asset resulting from potentially higher depreciation and interest expenses, it is reasonable to restrict the allowable property related costs on the purchased capital asset to the amount allowed for the lease or rental agreement prior to the sale. This provision is consistent with the intent of the Deficit Reduction Act, 1984 which prohibits increases in reimbursements because of sales. This provision also addresses concerns raised in the LAC Report. (LAC Report, 1983: p. 71.)

XI. DETERMINATION OF THE TOTAL PAYMENT RATE - Part 9553.0070

Statement of Need and Reasonableness:

Subpart 1 provides for the computation of the total payment rate as the sum of the separately determined rates for the total operating cost payment rate and the property related cost payment rate. This provision is necessary and reasonable in order to establish one payment rate for each facility for billing purposes.

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Subpart 2 establishes limitations on the total payment rate and provides for exceptions. The private pay limitation is necessary and reasonable to assure that the Medical Assistance Program does not pay more than private payors for similar services. It is reasonable to exclude from this limitation rates established by the commissioner for very dependent persons with special needs since the additional services required by these persons are by definition not included in the payment rate.

Subpart 3 requires respite care rates to be separately identified. This is reasonable because respite care services may be determined by other funders thus, a differential in rates may be appropriate.

Subpart 4 provides for an adjustment to a total payment rate in effect for a period greater than 12 months due to the phase-in of a common reporting year. This is reasonable because a payment rate is normally in effect for 12 months and a longer period warrants recognition. The CPI-U is an established, independent index of price level changes.

XII. RATE SETTING PROCEDURES FOR NEWLY CONSTRUCTED OR NEWLY ESTABLISHED FACILITIES OR APPROVED CLASS A TO CLASS B CONVERSIONS - PART 9553.0075

Statement of Need and Reasonableness:

Subpart 1 establishes procedures, rule applicability, effective dates, and special rate setting requirements for newly constructed or established facilities prior to receiving reimbursement from the Medical Assistance Program. It is necessary to establish interim rate procedures for these facilities because a historical base from which rates are derived does not exist. Thus, it is reasonable to use budgeted amounts for the purpose of calculating rates. It is also necessary to allow some conversion of Class A beds to Class B beds in order to meet the Department's stated program objectives of providing habilitation services to a larger number of persons not capable of self-preservation in community ICF/MR settings.

It is necessary and reasonable to permit the use of the interim and settle-up rate setting procedures for an existing facility which is converting more than 50 percent of its licensed bed capacity from Class A to Class B because of the often significant increase in both operating and property cost which can occur when meeting the higher program, licensure, and certification standards.

It is reasonable to require the percent of beds being converted to be more than 50 percent since otherwise providers could receive interim rates almost perpetually by making a series of minor conversions to Class B beds each reporting year. The result would be an ongoing circumvention of the cost containment measures these rule parts provide.

The 50 percent requirement effectively limits interim status to once for conversions and thus the advantages of interim status over the normal rate setting procedures will not constitute an incentive for continuous change.

It is reasonable to require the projected cost report to be in compliance with rule procedures as the intent is to establish a rate in the context of these rule parts. It is also necessary and reasonable to not apply specific parts of the rule to interim rates when operational differences between projected costs and historical costs are evident. For example, efficiency allowances are not paid to interim rate facilities. This is

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reasonable because there is no rationale on which to base the needed comparison to determine such efficiency. Also, the limits on the historical operating cost base are not applied for that same reason. This is also the reason for excluding the energy conservation incentive from inclusion in the rates. It would be unreasonable and inappropriate to pay incentives based upon reductions from budgeted rates. The one-time adjustment is reasonably removed from interim rate calculations because the facility's budget rate should be based upon compliance with program standards. Property costs are divided by the greater of projected resident days or 80 percent of licensed capacity. This is reasonable because property costs are considered a fixed cost. In order to encourage only the development of needed ICF/MR beds and appropriate utilization of services, and to assure efficient and prudent management of capital assets, it is reasonable to require a lower limit of 80 percent of licensed capacity days. Also, if a lower limit was not established, no incentives would exist to fill the beds and more efficiently allocate the property related costs among the facility's residents. The effective date of the interim rate is reasonable as it assures that the facility is certified, or appropriately licensed in the case of conversions, and has a Medical Assistance recipient before payments are made. It is reasonable to update an interim rate before the effective date so that the time lag between the request and the effective date becomes immaterial to cost.

Statement of Need and Reasonableness:

Subpart 2 establishes procedures for the interim rate settle-up. It is necessary to have a rate settle-up because the interim rates were based upon a budget. Also, it is necessary to have a mechanism to adjust for unanticipated changes. A settle-up cost report must be filed with actual costs for the interim period ending December 31 so that the interim time period ends with the normal reporting year for all providers. An interim period of 6 to 17 months is necessary and reasonable so that the interim period has a reasonable time frame to establish an on-going operation with an accurate historical cost base.

Item A requires the settle-up of interim rates established before January 1, 1986 to be calculated according to rules in effect at the time of establishment. This is a necessary and reasonable provision to accommodate those providers whose interim rates were established under prior rules.

Item B establishes procedures for a settle-up when the interim rate is established after December 31, 1985. The necessity and reasonableness of excluding the various rule provisions listed in subitem 1 were discussed in subpart 1. The rationale for the occupancy incentives in subitems 2 and 3 were also discussed in subpart 1. Subitem 4 allows for a .4166 percent per month increase in the settle-up rate from the projected rate. It is necessary and reasonable to limit increases to an annualized increase of 5 percent so that incentives are created to accurately budget and effectively manage the facility's budget during the interim period. It is also reasonable because the Department needs to have a rational basis for evaluating the reasonableness of a project. The entire planning process becomes ineffective if wide differences between the settle-up rate and budgeted rate result. Also, Minnesota Statutes, section 256B.501, subdivision 3 states that the procedures shall include cost containment measures to assure efficient and prudent management of capital assets and operating cost increases that do not exceed increases in other sections of the economy.

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Statement of Need and Reasonableness:

Subpart 3 establishes operating and property rate adjustments necessary for the nine-month period between the December 31 settle-up and the October 1 start of the next rate year. It is necessary and reasonable to do so because changes in costs attributable to the economy are reflected in that rate by adjusting the cost by the annualized CPI-U. Rates must be calculated according to the rule except that the limits on the historical base, efficiency allowances, the one-time adjustment, and the energy conservation incentive are not applicable. It is reasonable to exclude the historical operating cost limits and the efficiency allowance because the payment rates derived for the nine-month period are based upon the same historical costs, thus any comparison between the rate periods is meaningless. Energy incentives and the one-time adjustment are excluded because the facility's budget can reasonably be expected to include appropriate staffing ratios and energy conservation measures. Thus, these costs should already be built into the facility's historical cost base. Resident days are calculated at the greater of actual days in the period or an annualization of the last three months to not less than 85 percent of capacity so that rates more closely reflect operations of an ongoing entity. If this is not done, the payment rates could be skewed by start-up conditions such as a low occupancy rate due to a slow fill rate. It is reasonable to adjust the operating costs by the change in the Minneapolis CPI-U for the previous calendar year because this is the same index that is applied to the other facilities that are not utilizing the interim rate procedures.

Statement of Need and Reasonableness:

Subpart 4 establishes procedures for the calculation of the first payment rate after the interim rate period. It is necessary and reasonable to establish payment rates using the normal rate setting procedures used by all providers because by that time the provider would have been in operation for a length of time sufficient to have historical cost experience and the operation can be expected to be stable and predictable.

XIII. APPEALS PROCEDURES, PART 9553.0080

Statement of Need:

In order to protect the ICF/MR providers' rights to due process of law it is necessary to establish an appeals process for ICF/MR providers.

Reasonableness:

Due to the similarities in the reimbursement rules between nursing homes and ICFs/MR, it is reasonable to pattern the appeal process for ICF/MR providers after the appeal process for nursing homes. The authority for the nursing home appeal process Minnesota Statutes, section 256B.50. This avoids confusion by creating consistency for similar providers. Also, it is reasonable because some providers have payment rates established under both reimbursement rules.

Statement of Need and Reasonableness:

Subpart 1 establishes the scope of appeals. Item A limits appeals to issues that would have an impact on the facility's total payment rate. This

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serves to limit the expenditure of public funds on disputes over insignificant issues. Also, this is in compliance with Minnesota Statutes, section 256B.50, which spells out the appeals process for nursing home providers in Rule 50.

Statement of Need:

Item B is necessary in order to limit appeals to a specific set of rules or procedures to provide guidance and limitations to parties on both sides of the issue in dispute.

Reasonableness:

Since appeals are being limited to issues that would affect the facility's total payment rate and the total payment rate is determined by Minnesota Rules, part 9553.0010 to 9553.0080, it is reasonable to limit appeals to the application of the provisions of parts 9553.0010 to 9553.0080 or its predecessor rules.

Statement of Need:

Item C establishes the authority for the commissioner to informally resolve appeals. It is necessary to encourage informal resolution of appeals due to the substantial expenditure of time and public funds involved in formal dispute resolution.

Reasonableness:

This item encourages a less combative and less costly informal resolution of the dispute rather than requiring a significant outlay of public funds to conduct a formal resolution before less formal means of settlement have been tried.

Statement of Need:

Subpart 2 establishes procedures for filing an appeal.

Item A. Some restriction needs to be imposed concerning the time frame during which an appeal can be filed in order to provide for a timely settlement of the dispute.

Reasonableness:

It is reasonable to use the same appeal time frame for ICF/MR providers as is outlined for nursing home providers in Minnesota Statutes, section 256B.50, because of the similarities in the reimbursement process between nursing homes and ICFs/MR. This time frame is sufficient to facilitate the appeals process while allowing time to consider all the pertinent facts. It is reasonable to require written notification to provide evidence of the notification.

Statement of Need:

Item B establishes the necessity to have written documentation of what is being disputed, what the appealing party believes is correct and the authority on which their argument is based. This is necessary in order to resolve appeal issues in a timely and orderly manner.

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Reasonableness:

It is reasonable to require that the appealing party provide sufficient information about the issue in dispute so that viewpoints concerning the issue can be developed, presented, and resolved. It is reasonable that an ICF/MR appeal require the same specifics as a nursing home appeal as specified in Minnesota Statutes, section 256B.50, due to the similarities in the reimbursement process between nursing homes and ICFs/MR.

Statement of Need:

Subpart 3 establishes the method to be used for formal appeal resolution. Specific provisions regarding the conduct of the appeal are necessary for the timely and orderly settlement of the dispute.

Reasonableness:

It is reasonable to follow the same contested case provisions set forth in Minnesota Statutes, chapter 14, section 256B.50 and rules of the Office of Administrative Hearings that are used in the hearing of nursing home appeals to avoid confusion about the appeals procedures and requirements and to maintain consistency with other appeals processes developed by the Department.

Statement of Need:

Subpart 4 establishes the payment rate that will be paid during the pendency of an appeal. This provision is necessary in order to avoid confusion in the payment system.

Reasonableness:

Since the "correct" total payment rate will not be known until the dispute is resolved, it is reasonable that the total payment rate established by the commissioner should be the total payment rate paid to the provider while the appeal is pending. Also, this is in compliance with Minnesota Statutes, section 256B.50, which spells out the appeals process for nursing home providers.

Statement of Need:

Subpart 5 establishes guidelines concerning any underpayments or overpayments which result from the resolution of an appeal. This provision is necessary to insure the consistent and timely settlement of such payments.

Reasonableness:

It is reasonable to follow the rules regarding underpayments or overpayments as stipulated in part 9553.0041, subpart 13 so that a consistent method is employed.

Statement of Need:

Subpart 6 is necessary in order to provide a safeguard to the expenditure of public funds.

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Reasonableness:

It is reasonable that public funds be utilized to pay for expenses incurred during the appeal only for those cases in which the appeal is upheld. This restriction has the added effect of insuring that any appeals are substantial in nature and discourages the submission of large volumes of appeals on the theory that a certain percentage will be upheld. It is also reasonable to restrict the total payment rate to the limitations stipulated in part 9553.0070, subpart 2. Maximum payment rate restrictions already in effect should not be circumvented by the appeals process.

CONCLUSIONS

The foregoing statements address the need and reasonableness of the proposed rule parts 9553.0010 to 9553.0080. To a great extent the need for the rules are prescribed by state statute, federal requirements and the inherent responsibility of the Minnesota Department of Human Services to exercise prudent management of public funds.

WITNESSES

The Department will not have outside witnesses testify on its behalf at the public hearing.



LEONARD W. LEVINE, COMMISSIONER
DEPARTMENT OF HUMAN SERVICES

Date: 7/2/85

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